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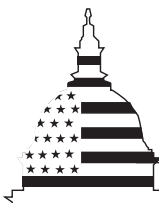
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# WORLD TRADE ORGANIZATION

## Observations on China's Rule of Law Reforms

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Accountability \* Integrity \* Reliability

## Report Documentation Page

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Mr. Chairman and Members of the Commission:

I am glad to have the opportunity today to discuss aspects of China's development of rule of law<sup>1</sup> practices that are related to the commitments China made to the World Trade Organization (WTO), which it joined on December 11, 2001. My observations address three areas: (1) How elements in China's WTO accession agreement<sup>2</sup> seek to improve the rule of law; (2) What Chinese officials told us about their reform efforts; and (3) What the U.S. business community has told us about the importance of these efforts and their views on rule of law implementation in China to date.

My statement today is based on our ongoing work; therefore, my observations are preliminary in nature. As you know, both the Senate Finance and House Ways and Means committees have asked GAO to conduct a 4-year body of work relating to China's implementation of its WTO commitments. This includes analyzing China's final WTO commitments, performing annual business surveys, evaluating China's implementation of its commitments, and assessing executive branch monitoring and enforcement activities. Our work to date has included two trips to China; one trip to Geneva, Switzerland; numerous meetings with U.S. and Chinese government officials; and an assessment of preliminary results from a mail survey and structured interviews of U.S. companies doing business in China. We are finishing our analysis and verifying our work, and we plan to report the final results of our work in various products by mid-October.

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## Summary

Many elements in China's WTO accession agreement seek to improve the rule of law. When China joined the WTO, China agreed to ensure that its legal measures would be consistent with its WTO obligations. In our

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<sup>1</sup> Definitions of "rule of law" are varied. For purposes of this testimony, we generally use it to describe a society in which law, for the most part, guides people and the government in the conduct of their affairs and constitutes the supreme legal authority, in contrast to the authority of an individual ruler or a political party.

<sup>2</sup> China's WTO commitments are documented in its (1) *Protocol on the Accession of the People's Republic of China*, which contains the terms of membership that China negotiated and affirms China's adherence to the WTO agreements; (2) the *Report of the Working Party on the Accession of China*, which contains additional commitments as well as provides a narrative on the results of China's negotiations; and (3) annexes containing market access commitments, which primarily cover individual tariff lines for goods and schedules for various service sectors.

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analysis of China's WTO commitments, we found at least 60 commitments that specifically obligate China to enact, repeal, or modify trade-related laws or regulations. In addition, China has made a substantial number of other WTO commitments related to the rule of law areas of transparency, judicial review, uniform enforcement of laws, and nondiscriminatory treatment.

Chinese government officials have emphasized their commitment to make WTO-related reforms that will strengthen the rule of law. They described how their efforts for reform go beyond China's WTO commitments and include broad reforms of laws and regulations at the national and provincial levels, as well as reforms of judicial and administrative procedures. However, Chinese officials acknowledged the challenges they face in completing the necessary reforms, including the capacity of the government to carry out new functions in a timely manner. In addition, despite an extensive training program about WTO-related reforms throughout the country, officials identified the need for outside assistance, because they lacked the expertise and capacity to meet all their training needs themselves.

According to the preliminary results of our survey, U.S. businesses in China consider rule of law-related WTO commitments to be important to them, especially the consistent application of laws, regulations, and practices in China, and enforcement of intellectual property rights. However, a majority of businesses answering our survey anticipated that these rule of law commitments would be difficult for the Chinese to implement, and they identified some concerns over specific implementation issues. U.S. businesses told us in interviews that they expected WTO reforms, including those related to the rule of law, to be part of a long-term process. Nevertheless, they believe the Chinese leadership is dedicated to living up to their WTO commitments.

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## Background

Rule of law reform must take place within China's legal and political system, and any assessment of rule of law development should be judged in the context of Chinese institutions. China's current legal system is relatively new and is based, to a great extent, on the civil law codes of Germany as adopted by Japan, and, to some extent on the legal institutions of the former Soviet Union and China's traditional legal system. Two important characteristics of Chinese legal development since 1949 have been the subordination of law to Communist Party policy and the lack of independence of the courts. Another characteristic is the large number of legal measures used to implement a law, including administrative

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regulations, rules, circulars, guidance, Supreme People's Court interpretations, and similar local government<sup>3</sup> legal measures. China's central government laws, regulations, and other measures generally apply throughout China. Although local governments enact laws and regulations, these must be consistent with central government measures. In 1996, a number of China's top leaders emphasized the principle of administering the country in accordance with law. Several years later, China amended its constitution to incorporate this principle.

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## Many Elements in China's WTO Accession Agreement Seek to Improve the Rule of Law

A substantial number of the many commitments that China has made to the WTO can be characterized as related to developing rule of law practices. In a broad sense, China's WTO commitments suggest that in its commercial relations China is on the way to becoming a more rules-based society, contingent on the faithful implementation of its WTO accession agreement. This agreement is highly detailed and complicated, running to over 800 pages including annexes and schedules. It is the most comprehensive accession package for any WTO member. As part of this package, China agreed to ensure that its legal measures would be consistent with its WTO obligations. About 10 percent of the more than 600<sup>4</sup> commitments that we identified in China's accession package specifically obligate China to enact, repeal, or modify trade-related laws and regulations. These commitments cover such trade policy areas as agricultural tariff-rate quotas, export and import regulation, technical barriers to trade, intellectual property rights, and nondiscrimination. In addition, by becoming a WTO member, China has agreed to abide by the underlying WTO agreements, such as the General Agreement on Tariffs and Trade, the General Agreement on Trade in Services, the Agreement on Trade-Related Aspects of Intellectual Property Rights and the Understanding on the Rules and Procedures Governing the Settlement of Disputes.

China also has made a substantial number of important, specific commitments in the rule of law-related areas of transparency, judicial review, uniform enforcement of legal measures, and nondiscrimination in its commercial policy. In the area of transparency, China has agreed to

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<sup>3</sup> Local governments include provinces, autonomous regions, municipalities directly under the central government, other municipalities, special economic areas, and counties.

<sup>4</sup> This number excludes market access commitments contained in China's tariff and services schedules.

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designate an official journal for publishing trade-related laws and regulations and to provide a reasonable period for public comment before implementing them. China has also agreed to designate an enquiry point where individuals, business enterprises, and WTO members can request information relating to these published laws and regulations. Transparency requirements and commitments to report information to the WTO together represent about a quarter of the commitments we identified in China's accession package. In the area of judicial review, China has agreed to establish or designate tribunals to promptly review trade-related actions of administrative agencies. These tribunals are required to be impartial and independent of the administrative agencies taking these actions. In the area of uniform enforcement, China has agreed that all trade-related laws and regulations shall be applied uniformly throughout China and that China will establish a mechanism by which individuals and enterprises can bring complaints to China's national authorities about cases of nonuniform application of the trade regime. Finally, in the area of nondiscrimination, China agreed that it would provide the same treatment to foreign enterprises and individuals in China as is provided to Chinese enterprises. China also agreed to eliminate dual pricing practices as well as differences in treatment provided to goods produced for sale in China and those produced for export. (See the appendix for examples of rule of law-related commitments included in China's WTO accession agreement.)

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## Chinese Officials Cite Early Reform Efforts But Recognize Challenges to Implementation

Chinese government officials have stated their commitment to make WTO-related reforms that would strengthen the rule of law. Furthermore, China's plans for reform go beyond conforming its laws and regulations to China's WTO commitments and include a broad legal review, as well as reforms of judicial and administrative procedures. Chinese officials with whom we spoke discussed the numerous challenges they face in these areas and said that these reforms will take time to implement. They also stated their need for outside assistance to help them with their reform efforts.

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## Early Reform Efforts in Three Areas

First, Chinese government officials are in the midst of a comprehensive, nationwide review of laws, regulations, and practices at both the central and provincial levels. This review is to lead to repeals, changes, or new laws. According to one report, Chinese officials have identified more than 170 national laws and regulations and more than 2,500 ministry regulations as being WTO related.

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Officials whom we interviewed from the Ministry of Foreign Trade and Economic Cooperation (MOFTEC) contend that generally China has done a good job of implementing its WTO obligations to date. MOFTEC officials said that complete implementation will take time and that part of their role is to teach other ministries how to achieve reform according to WTO commitments. They noted the importance of their efforts to coordinate WTO-related reforms with other ministries because Chinese laws tend not to be very detailed and, as a result, it is difficult to incorporate the language of specific WTO commitments into Chinese laws. Officials said that, consequently, Chinese laws will sometimes use general, open-ended phrases that refer to WTO commitments, such as the services annexes, while the detail is set forth in the implementing regulations .

Provincial authorities are still reviewing their laws and regulations to see if they are consistent with national laws. Provincial-level officials told us that in some cases they were still waiting for the national government to finish its legislative and regulatory processes. This process will guide their own review of laws and regulations at their level. Prior to their enforcement, provincial-level laws, regulations, and other regulatory measures that implement the central government's legal measures are submitted to the central government for review. Chinese officials told us that they have found many provincial regulations that did not conform to national laws and regulations. MOFTEC officials estimated that it would take a year or two to complete this entire reform process, while some provincial officials estimated 2-3 years.

Second, China is undertaking reform of its judicial processes to ensure that they are compatible with its WTO commitments. The Supreme People's Court informed us that since China's accession it has been revising hundreds of judicial interpretations about laws that do not conform to WTO rules. It has also instructed the judiciary throughout the country to follow the revised interpretations and to undertake similar work at their respective levels. Officials told us that the court is also involved in reforms related to the WTO areas of judicial independence and uniform application of legal measures. For example, with regard to judicial independence, in February of this year the court issued new regulations to improve the adjudication of civil and commercial cases involving foreign parties. Under these regulations, mid-level and high-level courts, in contrast to the basic-level courts, will directly adjudicate cases involving, among other subjects, international trade, commercial contracts, letters of credit, and enforcement of international arbitration awards and foreign judgments. Furthermore, China recently amended its Judges Law to

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require that new judges pass a qualifying exam before being appointed to a judicial position.

Third, China is reforming its administrative procedures and incorporating the rule of law into decision-making. About one third of the commitments we identified in China's WTO accession agreement relate to guidance about how a particular commitment should be carried out. Officials told us that they are attempting to reduce the number of layers necessary to approve commercial activities and to make these processes more transparent. These actions can help implement rule of law practices at the day-to-day level. These reforms are also still underway at the central and provincial levels. For example, State Economic and Trade Commission (SETC) officials told us that they have identified 122 administrative procedures that must be changed to conform to WTO rules but that 40 percent of these must still be changed. In Shanghai, officials said that they have eliminated 40 percent of government approvals under their jurisdiction and that they are working to make the remaining 60 percent more efficient.

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### Chinese Officials Acknowledge Challenges

Some Chinese officials with whom we spoke acknowledged challenges in completing all these reforms in a timely manner. These challenges include insufficient resources, limited knowledge of WTO requirements, and concerns about the effects on the economy of carrying out particular WTO commitments. For example, Chinese officials said that the effects of the changes needed to conform their tariff-rate quota administration process to WTO requirements were so difficult that they were unable to allocate the quota and issue certificates in time to meet the deadlines set forth in China's WTO commitments. A number of Chinese officials also indicated that it has been very difficult to fulfill a WTO transparency commitment that requires China to translate all its trade laws, regulations, and other measures into an official WTO language—English, French, or Spanish. This difficulty is due in part to the abundance of the materials to be translated and the highly technical quality of many legal measures.

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### Chinese Officials Identified the Need for More Technical Assistance

Many Chinese officials we interviewed emphasized the importance of the steps they had taken at both the national and subnational levels to increase the training of government officials about WTO rules. For example, the State Economic and Trade Commission and the General Administration of Customs said they have been holding training sessions for over a year at the national, provincial, and municipal levels on general WTO rules and China's WTO obligations. In addition, the National Judges



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College plans to train 1,000 judges from local courts across the country and send others for training abroad. Furthermore, governments in Shanghai, Guangzhou, and Shenzhen have established WTO affairs consultation centers that organize training and international exchange programs for midlevel Chinese officials on implementing WTO reforms.

Despite these efforts, Chinese officials acknowledged that their understanding of WTO rules remains limited and that more training is needed. According to several Chinese government officials we interviewed, China continues to lack the expertise and the capacity to provide all the training necessary to implement WTO rules and, therefore, it has asked for technical assistance both multilaterally and bilaterally from outside China. As a result, the WTO secretariat, the European Union, the United States, and other WTO member countries have either given or plan to give training assistance to China in numerous areas, including rule of law-related programs. For its part, the U.S. government has provided limited training on a range of WTO-related topics, including standards, services, antidumping requirements, and intellectual property rights. The U.S. private sector also has provided technical assistance. In our interviews of U.S. businesses in China, almost one third of respondents said that they had given some assistance to China that related to implementation of China's WTO commitments.

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## Rule of Law-Related Reforms Are Important for U.S. Business, but Difficulties Anticipated

Preliminary data from our written survey indicate that China's WTO commitments related to rule of law reforms are some of the most important for U.S. businesses with a presence in China.<sup>5</sup> For example, more than 90 percent of businesses that have responded to date indicated that the following reform commitments were important or somewhat important to their companies:

- consistent application of laws, regulations, and practices (within and among national, provincial & local levels);
- transparency of laws, regulations, and practices;
- enforcement of contracts and judgments/settlement of disputes; and
- enforcement of intellectual property rights.

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<sup>5</sup> We have surveyed more than 500 U.S. companies with a presence in China and have received more than 175 usable responses as of the date of this testimony.

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When asked to identify the three commitments that were most important to their companies, two WTO rule of law-related areas received the greatest number of responses in our written survey — consistent application of laws, regulations, and practices; and enforcement of intellectual property rights. We will include a more complete analysis of these and other issues considered in our business survey in a report to be released this fall.

A majority of businesses answering our survey expected these rule of law commitments to be difficult for China to implement relative to its other WTO commitments. Businesses cited a number of reasons for this relative difficulty, including (1) the cultural “sea change” required to increase transparency; (2) a reluctance to crack down on intellectual property right violations stemming from a fear of destabilizing the labor force; and (3) the challenge of implementing laws, rules, and regulations consistently among provinces and within and among ministries.

Similarly, in our interviews, company officials noted the magnitude of WTO-related reforms, including those that would strengthen the rule of law.<sup>6</sup> They said that successful implementation would require long-term effort. Commensurate with the expected difficulty in carrying out reforms, we heard numerous specific individual complaints from U.S. companies, including concerns about

- vague laws and regulations that create uncertainty for foreign businesses;
- lack of transparency, which denied foreign companies the ability to comment on particular draft laws or regulations or to respond to administrative decisions;
- conflicting and inconsistent interpretations of existing laws and regulations from Chinese officials;
- unfair treatment by, and conflicts of interest, of Chinese regulators; and
- uneven or ineffective enforcement of court judgments.

Nevertheless, U.S. businesses in China believe that the Chinese leadership is strongly committed to reform and that the leadership has communicated this commitment publicly. Several private sector officials noted a more open, receptive, and helpful attitude on the part of the government officials with whom they had contact. Other private sector officials noted

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<sup>6</sup> We interviewed representatives from more than 50 companies in China as well as representatives from U.S. industry associations.

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more specific positive actions. For example, officials noted improvements in intellectual property right protections including crackdowns against counterfeiters in Shanghai, and a case where a U.S. company won a judgment against a counterfeiter in a Chinese court that included an order to cease the operations of the copycat company.

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## Concluding Observations

First, it is very clear that China has shown considerable determination in enacting the numerous laws, regulations, and other measures to ensure that its legal system and institutions, on paper, are WTO compatible. Nevertheless, the real test of China's movement toward a more rule of law-based commercial system is how China actually implements its laws and regulations in fulfilling its WTO commitments. At this point, it is still too early for us to make any definitive judgments about China's actual implementation. Second, as you know, it has been the hope of U.S. government officials and others that China's accession to the WTO would constitute a significant step forward in China's development toward becoming a more rule of law-oriented society. It is worth noting that China's reform efforts, which have been ongoing for more than 20 years, have included substantial legal developments that could be described as rule of law related. These include the enactment of numerous laws, regulations, and other measures that apply to many aspects of Chinese society beyond the WTO, the recent proliferation of law schools and legal training, and the recognition of the need for judicial reform. It is still too early to know where this process will lead, but there is hope that the many rules-based commitments that China made to become a WTO member will influence legal developments in other areas.

Mr. Chairman, this completes my prepared statement. I would be happy to respond to any questions you or other Members of the Commission may have at this time.

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## Contacts and Acknowledgments

For future contacts regarding this testimony, please call Susan Westin at (202) 512-4128. Adam Cowles, Richard Seldin, Michelle Sager, Matthew Helm, Simin Ho, Rona Mendelsohn also made key contributions to this testimony.

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# Appendix I: Examples of Rule of Law-Related Commitments Included in China's World Trade Organization Accession Agreement

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## Transparency

- Trade Framework: China shall make available to WTO members, upon request, all laws, regulations and other measures pertaining to or affecting trade in goods, services, TRIPS or the control of foreign exchange, before such measures are implemented or enforced. (Protocol paragraph 2.C.1)
- Services: China would publish in the official journal, by appropriate classification and by service where relevant, a list of all organizations that were responsible for authorizing, approving or regulating services activities whether through grant of license or other approval, including organizations delegated such authority from the national authorities. (Working Party report paragraph 332)

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## Judicial Review

- Trade Framework: China shall establish or designate, and maintain tribunals, contact points and procedures for the prompt review of all administrative actions relating to implementation of laws, regulations, judicial decisions and administrative rulings of general application referred to in Article X:1 of the GATT 1994, Article VI of the GATS and relevant TRIPS provisions. (Protocol paragraph 2.D.1)
- Intellectual Property Rights: Appropriate cases, including those involving repeat offenders and willful piracy and counterfeiting, would be referred to relevant authorities for prosecution under the criminal law provisions. (Working Party report paragraph 299)

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## Uniform Enforcement

- Trade Framework: China shall apply and administer in a uniform, impartial and reasonable manner all central government laws, regulations and other measures and local regulations, rules and other measures issued or applied at the sub-national level. The laws, regulations and other measures covered are those that pertain to or affect (1) trade in goods, (2) services, (3) trade-related aspects of intellectual property rights (TRIPS), and (4) the control of foreign exchange. (Protocol paragraph 2.A.2)
- Trade Framework: China would strengthen the uniform enforcement of taxes, tariffs and non-tariff measures on trade between its special economic areas and the other parts of China's customs territory. (Working Party report paragraph 225)

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## Nondiscrimination

- Import Regulation: China would adopt and apply tariff reductions and exemptions so as to ensure MFN treatment for imported goods. (Working Party report paragraph 111)
  - Import/Export Regulation: Except as otherwise provided for in this Protocol, foreign individuals and enterprises and foreign-funded enterprises shall be accorded treatment no less favorable than that accorded to other individuals and enterprises in respect of the distribution of import and export licenses and quotas. (Protocol paragraph 8.2)
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Source: Protocol on the Accession of the People's Republic of China and Report of the Working Party on the Accession of China, World Trade Organization.